Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matters of	)	
	)	
BellSouth Telecommunications, Inc.	)	CC Docket No. 98-161
BellSouth Tariff FCC No. 1	)	
BellSouth Transmittal No. 476	)	
	)	
GTE Telephone Operating Companies	)	CC Docket No. 98-79
GTOC Tariff FCC No. 1	)	
GTOC Transmittal No. 1148	)	
	)	
Pacific Bell Telephone Company	)	CC Docket No. 98-103
Pacific Bell Tariff FCC No. 128	)	
Pacific Transmittal No. 1986	)	

MOTION TO FILE COMMENTS ONE DAY LATE

Pursuant to Section 1.46(b) of the Commission's rules, 47 C.F.R. § 1.46(b), ACI Corp. and FirstWorld Communications, Inc., by their attorneys, respectfully submit this motion to file comments in this docket one day late. Failure of counsel's PBX trunks prevented communication with our clients in order to obtain review and final approval of the comments in the matter captioned above, and thus necessarily delayed the timely submission of the attached comments.

All parties and Commission Staff, including the Common Carrier Bureau's Enforcement Division, were timely served with the attached comments before 10:00 a.m. on Monday, September 21, 1998. As a result, neither the parties nor the Commission will be prejudiced by this brief and unavoidable delay. The Commission's inclusion of the comments in the record is in the public interest, will not prejudice interested parties and will provide input that will allow the

Commission to more completely examine the issues raised in its Order Designating Issues for Investigation.

WHEREFORE, this motion should be granted as the inclusion of the comments in the record is in the public interest and will not prejudice interested parties.

Respectfully submitted,

ACI CORP. AND FIRSTWORLD COMMUNICATIONS, INC.

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Dated: September 21, 1998

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COMMENTS OF ACI CORP. AND FIRSTWORLD COMMUNICATIONS, INC. ON THE DIRECT CASES OF BELLSOUTH, GTE AND PACIFIC BELL

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Dated: September 21, 1998

SUMMARY

BellSouth, GTE and Pacific Bell (the "ILEC Respondents") have correctly concluded that their DSL services are interstate special access services properly tariffed under federal jurisdiction. However, while this conclusion is correct, the ILEC Respondents' analysis is not. Their DSL services are not interstate on the asserted ground that the ILEC Respondents are providing "Internet access." The ILECs offer data connectivity between end users and their ISPs, but it is the ISPs who are providing Internet access, not the ILEC DSL service. Rather, the ILEC DSL services are jurisdictionally interstate because they are dedicated, mixed-use facilities used to transport both intrastate and interstate traffic, and as such are evaluated under the Commission's long-standing "ten percent rule" for jurisdictional classification of dedicated private line and special access services. DSL is a data transport technology that can be used to provide a number of different high-speed data services, many of which, like the ILEC Respondents' services in these dockets, are properly classified as interstate telecommunications services.

The Commission is also considering whether or not to "delegate" to state commissions its power to govern tariffing of DSL services, on the ground that state commissions, based on their authority over unbundled network element prices and relative expertise in the costing data, should evaluate whether or not ILECs have priced their inputs and retail DSL services in such a way as to create an illegal price squeeze. The Commission has the settled authority to review all interstate tariffs to determine whether or not they are anticompetitive and thus inconsistent with the Communications Act. The Commission should not delegate this authority to state commissions with respect to Respondents' DSL services, for several reasons.

First, while the price squeeze concerns of new entrants are significant and well-placed, the Commission has full authority to prevent and punish illegal price squeeze conduct. Second,

the Commission is well-versed in addressing the price squeeze concerns of new entrants and has, in the past, successfully forestalled attempts by ILECs to shift costs to monopoly services in order to justify retail rates that effect a price squeeze. If upon review the ILEC Respondents' rates cannot possibly account for the unbundled loop and other input costs needed to provide those services, the Commission should reject their interstate tariffs and give the ILECs a simple remedy: either lower the costs of inputs at the state level, or cease the cross-subsidization of their retail interstate DSL rates. Third, the Commission has already initiated proceedings that will provide an additional check on the ability of the ILECs to impose an illegal price squeeze by allowing the ILECs to offer advanced services, including those based on DSL technologies, through affiliates. In the past the Commission has correctly viewed affiliate arrangements, with the proper safeguards, as providing ILECs with a disincentive to engage in anticompetitive pricing.

Some parties have erroneously argued that classifying and tariffing Respondents' DSL services as interstate would allow ILECs to avoid their obligation to pay mutual or reciprocal compensation to CLECs for the origination and termination of "dial-up" calls from end users to ISPs. This is simply not the case. DSL technology can be used to provide both interstate and intrastate services, and in the case of Respondents' services, DSL technology is being used to provide dedicated, interstate services. Thus, a finding that Respondents' DSL services are properly interstate special access services will not prevent CLECs from collecting mutual compensation for ordinary, "dial-up" traffic terminated to ISPs.

In keeping with the fact that DSL technology can be used in conjunction with UNEs to provide interstate services, the Commission should, as it addresses these jurisdictional issues, vigilantly protect new entrants' rights to access UNEs and collocation under Section 251 of the

1996 Act. The Commission should expressly reaffirm in this proceeding the obligation of ILECs to provide UNEs, including DSL-capable loops, for use by competitors in providing interstate services.

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COMMENTS OF ACI CORP. AND FIRSTWORLD COMMUNICATIONS, INC. ON THE DIRECT CASES OF BELLSOUTH, GTE AND PACIFIC BELL

ACI Corp. and FirstWorld Communications, Inc. ("Commenters"), by their attorneys, respectfully submit these comments in response to Respondents' Direct Cases[1] on the Commission's Orders Designating Issues for Investigation (*"Designation Orders"*)[2] in the three above-captioned dockets.

ACI and FirstWorld are both competitive local exchange carriers ("CLECs") seeking to promote competition and reasonable rates in the market for Digital Subscriber Line ("DSL")

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[1] BellSouth Telecommunications, Inc. BellSouth Tariff FCC No. 1, BellSouth Transmittal No. 476, Direct Case of BellSouth, CC Docket No. 98-161 (filed Sept. 11, 1998) ("BellSouth Direct Case"); GTE Telephone Operating Companies GTOC Tariff FCC No. 1 GTOC Transmittal No. 1148, Direct Case of GTE, CC Docket No. 98-79 (filed Sept. 8, 1998) ("GTE Direct Case"); SBC Communications, Inc. for Pacific Bell Telephone Company Pacific Bell Tariff FCC No. 128, Pacific Transmittal No. 1986, Direct Case of Pacific Bell, CC Docket No. 98-103 (filed Sept. 11, 1998) ("Pacific Bell Direct Case").

[2] BellSouth Telecommunications, Inc. BellSouth Tariff FCC No. 1, BellSouth Transmittal No. 476, Order Suspending Tariff and Designating Issues for Investigation, CC Docket No. 98-161 (rel. Sept. 1, 1998); GTE Telephone Operating Companies GTOC Tariff FCC No. 1 GTOC Transmittal No. 1148, Order Designating Issues for Investigation, CC Docket No. 98-79 (rel. Aug. 20, 1998); Pacific Bell Telephone Company Pacific Bell Tariff

based services. ACI and FirstWorld believe that vigorous competition in the high-speed data market can only arise if retail DSL services are tariffed under the proper jurisdiction, in this instance as interstate services, and where there is effective regulatory oversight over retail DSL prices of incumbent local exchange carriers ("ILECs") to protect against anticompetitive pricing, including price squeezes.

INTRODUCTION

BellSouth, GTE and Pacific Bell (the "ILEC Respondents") filed amendments to their interstate tariffs to include DSL services as interstate special access services.[3] DSL is an advanced data transport technology that allows the provisioning of high-speed transmission of digital data, voice and video over compatible copper local loops far more efficiently than existing services.[4] Several parties filed Petitions to Reject, Deny or Investigate these tariffs on several grounds, including that: (1) the tariff was not properly before the FCC; (2) the tariff included a improper bundling of services; and (3) the rates at which the ILEC Respondents offered the service were unlawful under the Telecommunications Act of 1996 and the antitrust laws.[5]

In response to these petitions, the Commission suspended Respondents' tariffs for one day[6] and opened investigation proceedings on Respondents' tariffs to address two principal is-

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FCC No. 128, Pacific Transmittal No. 1986, Order Designating Issues for Investigation, CC Docket No. 98-103 (rel. Sept. 2, 1998) ("Designating Order").

[3] BellSouth Transmittal No. 476 (filed August 18, 1998); GTE Transmittal 1148 (filed May 15, 1998); Pacific Transmittal No. 1986 (filed June 15, 1998).

[4] Respondents have priced their basic DSL services as follows: BellSouth's rate is $45.00 per month, with a non-recurring charge of $100; GTE's rate is $40.00 per month, with a non-recurring charge of $60.00; and Pacific Bell's rate is $59.00 per month, with a non-recurring charge of $125.00. BellSouth Transmittal Section 7.5.21(A); GTE Transmittal Section 16.6(H); Pacific Bell Transmittal 17.7.4.

[5] The following Petitioners challenged Respondents' tariffs : America Online, Inc.; Association for Local Telecommunications Services; California Cable Television Association; Commercial Internet Exchange Association; Covad Communications Company; Cox Communications, Inc.; e*spire Communications, Inc.; Focal Communications, Inc; Hyperion Communications, ICG Communications, Inc.; Intermedia Communications, Inc.; ITC^DeltaCom Communications, Inc.; KMC Telecom Inc.; MCI Communications Corp; Network Solutions Access, Inc.; Northpoint Communications, Inc.; Sprint Corporation; Teleport Communications Group, Inc.

[6] BellSouth Telecommunications, Inc. BellSouth Tariff FCC No. 1, BellSouth Transmittal No. 476, Order Suspending Tariff and Designating Issues for Investigation, CC Docket No. 98-161 (rel. Sept. 1, 1998); GTE

sues: first, whether Respondents' DSL services are interstate services subject to the Commission's jurisdiction; and second, whether the FCC should defer pricing authority to the states in order to prevent anticompetitive pricing practices.

The answers to the Commission's questions depend on understanding the network architecture of DSL technology as well as the nature of the DSL market. DSL is a transmission technology with a wide variety of potential applications that offers tremendous promise to invigorate the provision of advance telecommunications and information services. New entrants can use DSL technology to provide both intrastate and interstate services. In the case of Respondents, their services use DSL, via local loops and dedicated, non-switched facilities, to deliver traffic to Internet Service Providers ("ISPs"). Like Respondents, DSL competitors must use the local exchange network, and thus purchase unbundled network elements ("UNEs"), i.e., copper loops, to combine with their own DSL equipment. These unbundled elements are the most essential, and most difficult to acquire, input for the provisioning of DSL services. Accordingly, ILECs with bottleneck control over these inputs wield an enormous amount of power with respect to the ability of competitive providers to provision DSL services.

Telephone Operations GTOC Tariff No. 1 GTOC Transmittal No. 1148, Order, CC Docket 98-79 (re. May 29, 1998); Pacific Bell Telephone Company Pacific Bell Tariff FCC No. 128, Pacific Transmittal No. 1986, Order D, CC Docket No. 98-103 (rel. July 29, 1998).

DISCUSSION

I. RESPONDENTS' PROPOSED APPLICATION OF DSL IS AN INTERSTATE COMMUNICATIONS SERVICE

The fundamental question posed in this proceeding is whether the ILEC Respondents' DSL services are jurisdictionally interstate, thereby falling within the FCC's jurisdiction. Under the Communications Act of 1934, the Commission's exclusive jurisdiction extends to "all interstate and foreign communication by wire or radio," 47 U.S.C. § 152(a), which by definition includes all transmissions that occur, in whole or in part, between states, regardless of the physical location of the underlying facilities.[7] The inquiry to determine jurisdictional classification must therefore "contemplate[] the regulation of interstate wire communication from its inception to its completion."[8]

Respondents are correct that their proposed application of DSL must be classified as an interstate service, although their analysis of this complex issue is faulty. Respondents' service as provided to ISPs are not interstate merely because the ISP end users apply DSL as part of their own Internet services. Although the Internet is inherently interstate, the "end-to-end analysis" proposed by Respondents does not dictate that its DSL service, unlike an ISP's service, is interstate.[9] Rather, the ILECs' applications of DSL technology provide access services to their ISP customers that fall within well-established Commission precedent governing the jurisdictional classification of private lines and special access services. This settled jurisdictional regime classifies Respondents' DSL services as interstate without the need to resort to any "inseparability" state preemption analysis.

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[7] See National Ass'n of Regulatory Utils. Commr's v. FCC, 746 F.2d 1492, 1500 (D.C. Cir. 1984) ("NARUC")("[T]he FCC has for years exercised jurisdiction over intrastate facilities that were partially used to complete interstate telephone calls.").

[8] United States v. AT&T, 57 F. Supp. 451, 454 (S.D.N.Y. 1994), aff'd, 325 U.S. 837 (1945).

[9] BellSouth Direct Case at 9; GTE Direct Case at 15-20; Pacific Bell Direct Case 3-10.

A. Respondents' DSL Services Merely Provide Connectivity Between Internet Service Providers and Their Subscribers

DSL technology provides a dedicated communications conduit, a "transparent, unenhanced, transmission path,"[10] over which Internet content can be packet-switched between users, including Internet Service Providers (ISPs) and their subscribers. Although ISPs will use this technology to provide Internet access services that are decidedly interstate, the ILEC Respondents are incorrect in arguing that this fact, in itself, necessarily classifies their own DSL as interstate.[11]

Respondents cannot stand in the shoes of their ISP customers for purposes of jurisdictional classification, since they are not using DSL to provide Internet access services. Were Respondents providing both the DSL service and the interstate Internet service, their arguments would be correct. The ILECs, however, are providing to their ISP customers only the dedicated line between the ISP points or presence ("POPs") and their subscribers' modems. It is the nature of this access line— not the Internet service offered by the ILECs' ISP customers — that defines the nature of Respondents' DSL services as interstate communications.

B. Respondents' DSL Services Are Interstate Special Access Services Subject to Federal Jurisdiction Under the Commission's "Mixed Use" Classification Regime

Respondents are offering DSL service to Internet and data service providers in the form of a dedicated point-to-point communications service. Their DSL technology is new, but the manner in which Respondents will provide it is not. As applied by the ILEC Respondents, DSL service is a modern version of the private lines that high-volume voice telephony customers have

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[10] Deployment of Wireline Services Offering Advanced Telecommunications Capability et al., Memorandum Opinion and Order, FCC 98-188, ¶ 36 (rel. Aug. 7, 1998). The Commission uses these terms to describe "basic" telecommunications that is regulated under Title II of the Communications Act. See Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer II), 77 FCC.2d 384, 419-20 (1980); Universal Service Report to Congress, FCC 98-67, ¶ 45 (rel. Apr. 10, 1998)("Stevens Report"),.

for years purchased as a means of obtaining direct access to interexchange carrier ("IXC") networks. DSL is simply a new provision of special access, having the advanced characteristics of advanced telecommunications capability. The regulatory tradition of private lines must therefore be the regulatory scheme for DSL, and the ILEC DSL services should remain within the Commission's jurisdiction as interstate telecommunications services.

The Commission has already classified DSL as an access service in its recent Memorandum Opinion and Order regarding high-speed data services.[12] Access services comprise two categories: special access services and switched access services.[13] Special access services "do not use the local switch; they are dedicated facilities that run directly between the end user and the IXC's point of presence."[14] Since the ILEC DSL services provide a dedicated connection end users and ISP customer POPs, they plainly meet the definition of special access services.

The distinction between special access and local exchange services bears directly on the concerns raised by some Petitioners that the ILECs are seeking interstate classification of their DSL services only to evade reciprocal compensation requirements for Internet traffic delivered to ISPs over the Public Switched Telephone Network ("PSTN").[15] Unlike the local exchange services used by ISPs to provide the "last mile" of their Internet services, DSL special access

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[11] BellSouth Direct Case at 13; GTE Direct Case at 7-8; Pacific Bell Direct Case at 4-10.

[12] Deployment of Wireline Services Offering Advanced Telecommunications Capability, Memorandum Opinion and Order, FCC 98-188, ¶ 22 (rel. Aug. 7, 1998)("Advanced Services Memorandum and Order"). The Commission expressly rejected the argument of USWest that advanced services, such as DSL, are not access services because they connect end users to an ISP and not a traditional voice interexchange carrier (IXC). The plain language and legislative history of the 1996 Act, the FCC concluded, "refutes any attempt to tie these statutory definitions to a particular technology." Advanced Services Memorandum and Order ¶ 42. The Commission should similarly reject this argument as repeated in this proceeding. ALTS Petitions on BellSouth tariff at 11-12, on GTE's tariff at 9-10, and on Pacific Bell tariff 9-10; Focal Communications and ICG Communications Petition on GTE tariff at 2-3.

[13] Access Charge Reform, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-48, ¶ 24 (1996).

[14] Id. ¶ 24.

[15] ALTS Petitions on BellSouth's tariff at 7-11, GTE's tariff at 9, and on Pacific Bell's tariff at 10; e*spire Communications Petitions on BellSouth at 2 and on GTE's tariff at 2.

provides a dedicated connection.[16] The fact that these dedicated DSL facilities may carry a calculable amount of intrastate traffic, whether Internet-related or purely data services, does not defeat the Commission jurisdiction. Rather, the Commission and reviewing courts have always recognized that the same facilities can transport both intra- and interstate traffic.[17] In the case of special access services, where the traffic carried along a single line is of "mixed use," meaning both intrastate and interstate in nature, the Commission has classified the service as jurisdictionally interstate and claimed exclusive jurisdiction.[18] Applying a *de minimis* standard, the Commission held that facilities carrying even a minimum amount of interstate traffic, designated at 10 percent of traffic on a single line, are interstate communications facilities.[19]

The settled "10 percent rule"[20] is therefore clearly applicable to the DSL services offered by the ILEC Respondents this case. It is clear that Internet and other interstate data communications comprise the predominant services that the ILEC DSL services will carry, thus easily qualifying these DSL services as interstate under the 10% criterion.

C. The Commission May Exercise Jurisdiction over Respondents' DSL Tariffs Without Any State Preemption

The ILEC Respondents also offer in support of their interstate argument the so-called "inseparability" doctrine,[21] under which the Commission may preempt state commission jurisdiction over communications services that cannot be separated into their intra- and interstate

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[16] ALTS notes that 17 state commissions have already made this determination as of the date of their petition. ALTS Petitions on BellSouth's tariff at 8, on GTE's tariff at 9, and on Pacific Bell's tariff at 9.

[17] See Smith v. Illinois Bell Telephone, 282 U.S. 133, 147 (1930)(noting that the portion of the network serving the city of Chicago carries local exchange service, intrastate toll service and interstate toll service); MTS and WATS Market Structure, Memorandum Opinion and Order, 97 FCC 2d 682, 711 (1983)(discussing private line WATS service as both local exchange and interstate toll service occurring over the same line).

[18] MTS and WATS Market Structure, 4 FCC Rcd. 5660 (1989)(referring specifically to the costs of providing "mixed use" special access as an interstate matter).

[19] Id.

[20] 47 C.F.R. § 36.154

[21] GTE Direct Case at 18-20; Pacific Bell Direct Case at 10-13.

components.[22] Although this argument may be germane to the jurisdictional status of DSL, it reaches into the realm of state preemption doctrine, which is a sensitive area that the Commission need not reach in order to dispose of these cases.

Because the Commission can rightfully claim exclusive jurisdiction over DSL based on its historical regulation of interstate special access services by virtue of the 10% rule, the issue of preempting state law does not arise. Respondents' DSL services are not subject to common law notions of separating communications traffic into its intra- and interstate parts. Rather, as has been demonstrated, DSL belongs to a class of special access services over which the Commission must retain exclusive jurisdiction. To illustrate, in a landmark case on communications jurisdiction case, the U.S. Court of the Appeals for the D.C. Circuit held that the Commission has exclusive jurisdiction over WATS as an interstate service[23] without employing preemption analysis. Therefore, the Commission can exercise exclusive jurisdiction over the ILEC DSL services under the "mixed use" regime without resorting to preemption of state jurisdiction.

II. THE COMMISSION SHOULD RETAIN ITS AUTHORITY OVER RESPONDENTS' DSL TARIFFS AND SHOULD REJECT DSL TARIFFS THAT EVIDENCE AN ANTICOMPETITIVE PRICE SQUEEZE

In the *Designation Order*, the Commission also sought comment on "whether the Commission should defer to the states the tariffing of retail DSL services in order to lessen the possibility of a price squeeze."[24] The rationale for this delegation is that new entrants providing services that compete with the DSL services of the ILEC Respondents rely on ILEC-controlled and state tariffed wholesale inputs, particularly unbundled loops and collocation, to provide their services. As a result, the ILECs are in the position to impose an illegal price squeeze on new entrants by controlling input costs, while simultaneously pricing their retail services below the

[22] See Louisiana Public Service Comm'n v. FCC, 476 US 335, 376 n.4 (1986).
[23] NARUC v. FCC, 746 F.2d 1492, 1501 (D.C. Cir. 1984).

total costs of the inputs needed to provide those services. Because state commissions have legal authority over UNE prices, and relative expertise in costing proceedings, some have suggested that the FCC should defer to state authority as a matter of comity.

ACI and FirstWorld believe that the Commission should not delegate authority over the DSL services of the ILEC Respondents to state commissions in order to lessen the possibility of an anticompetitive price squeeze, for several reasons. First, the price squeeze concerns of new entrants are significant and well-placed, and the Commission has within its own authority the full capabilities to prevent and punish illegal price squeeze conduct. Second, the Commission is well versed in addressing the price squeeze concerns of new entrants and has in the past successfully forestalled attempts by ILECs to shift costs to monopoly services in order to justify retail rates that effect a price squeeze. In protecting new entrants providing DSL services, the Commission should simply evaluate Respondents' DSL tariffs, and if upon review the ILECs' DSL rates cannot possibly account for the loop and other UNE costs needed to provide those services, the Commission should reject the DSL tariffs and give the ILECs a simple remedy: either lower the costs of inputs or cease the cross-subsidization of retail DSL services.

Third, the Commission has already initiated proceedings that may provide an additional check on the ability of the ILECs to impose an illegal price squeeze by allowing the ILECs to offer advanced services, including DSL services, through affiliates.[25] In the past, the Commission has viewed affiliate arrangements, with the proper safeguards, as providing ILECs with a disincentive to engage in anticompetitive pricing practices. Accordingly, until the Commission delineates the terms and structure of ILECs' option to provision their xDSL services through af-

[24] BellSouth Designating Order at 10; GTE Designating Order at 12; Pacific Bell Designating Order at 10.

[25] Advanced Services NPRM. In this NPRM, the Commission has indicated that it will consider whether to allow ILECs the option to provide DSL-based services through an affiliate not subject to the Section 251 and 271 obligations of the 1996 Act.

filiates and has a chance to determine whether affiliate arrangements will provide an additional protection against illegal price squeezes, the Commission should not defer its authority over Respondents' DSL tariffs to the states, as such action would be premature.

A. As a Matter of Law the Commission Has the Authority to Review Respondents' DSL Tariffs and Determine If the Tariffed Prices are Anticompetitive and Thus Inconsistent with the Communications Act

Sections 205 and 208 of the Communications Act provide the Commission with explicit power to review interstate service tariffs and determine whether or not interstate rates are unreasonable in view of the Commission's charge to protect the public interest, convenience and necessity. In particular, "the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge . . . what classification, regulation or practice is or will be just, fair and reasonable" and may order carriers to "cease and desist" from offering rates that are not just, fair and reasonable.[26] This authority plainly would extend to determining whether or not Respondents' DSL tariffs effect an illegal price squeeze.

It is unquestioned that price squeezes are not just, fair or reasonable and, as such, are inconsistent with the both the Communications Act and antitrust laws. As the Commission has noted, the opportunity to effect a price squeeze upon competitors exists when "an entity that provides both a retail product and a necessary input for providing that retail product possesses market power over that input."[27] Specifically, the anticompetitive nature of a price squeeze is such that "the input product is so high, relative to the price of the retail product, that competing providers of the retail service are unable to make a profit."[28] Such pricing practices are unequivocally anticompetitive. "When a monopolist competes by denying a source of supply to his com-

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[26] 47 U.S.C. §§ 205 and 208.

[27] Ameritech Operating Companies, Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Order, 11 FCC Rcd 14028, 14040-14041n.44 (1996).

[28] Id.

petitors, raises his competitor's price for raw materials without affecting his own costs, lowers his price for the finished goods, and then threatens his competitors with sustained competition if they do not accede to his anticompetitive designs, then his actions have cross the shadowy barrier of the Sherman Act."[29]

B. Input Costs Represent a Substantial Portion of Competitors' Costs for Providing DSL Services, and the Current Disparity Between ILECs' Input Charges and Retail Rates Effects an Illegal Price Squeeze

As the Commission's inquiry in these investigations suggest,[30] the threat of a price squeeze on new entrants arising from the DSL tariffs filed by the ILEC Respondents is very substantial. As the front-runners in the emerging DSL market, CLECs have spent more than a year wrangling with ILECs over the prices and terms for the wholesale inputs, including UNEs and collocation, that would enable competitors to provide fast, efficient and sophisticated DSL services. These wholesale inputs represent the majority of the costs that new entrants must bear in providing any DSL services that compete with services of the ILEC Respondents.

After jumping through many of the ILEC-imposed hoops to gain access to these inputs, CLECs are now, at long last, on the verge of becoming a significant presence in the market for high-speed services. Now, however, several ILECs are engaged in a "Johnny-come-lately" attempt to squelch the potential inroads of competitive providers by offering retail DSL-based services at below-costs rates that even the most efficient of competitors cannot match.[31]

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[29] Bonjorno v. Kaiser Aluminum Chemical Corp., 752 F.2d 802 (3d Circuit 1984).

[30] By raising the question in this matter of whether to defer xDSL tariffing authority to the states, the Commission assumes, and correctly so, that the possibility of price squeezing by ILECs threatens to halt the ability of CLECs to compete in the DSL market, and that, accordingly, determine there has to be some means of preventing this outcome.

[31] In addition to its investigations into the tariffs of BellSouth, GTE and Pacific Bell, the Commission has also opened an investigation on the ADSL tariff of Bell Atlantic. Bell Atlantic Telephone Companies Tariff No. 1, Transmittal No. 1076, Order Suspending Tariff and Designating Issues for Investigation, CC Docket No. 98-168 (rel. September 15, 1998).

ACI and FirstWorld have both been in interconnection negotiations with the ILEC Respondents, and thus have first-hand knowledge of the UNE and collocation costs associated with providing DSL services. Based on the costs of these inputs, the retail prices that the ILECs are now proposing to charge for their DSL services cannot possibly cover all the underlying costs for these services. Competitive providers of DSL solutions cannot compete at a price level with the ILECs' retail DSL services that do not include the same input costs that competitors must pay to provide similar services.

Unlike CLECs, the ILEC Respondents can sustain competitive services that operate at a loss in order to reduce retail prices or can use their monopoly services to subsidize services that are not quite up to par in a competitive market. New entrants have no such luxury. For many new CLECs, DSL services are their "bread-and-butter" services, and if these services operate at a loss, these CLECs will not be able to survive in a competitive market. Moreover, ILECs have the opportunity to make their DSL services appear more profitable and efficient by excluding some input costs — such as loop costs — on the grounds that these inputs are already used to provide their dominant services and are accounted for in the tariffing of those services. New CLECs providing DSL services do not have the luxury of eliminating input costs from their services through creative cost-shifting, making their services appear to be less efficient than they are in fact.

In their Direct Cases, the ILEC Respondents, GTE in particular, have sought to create the false impression that new entrants should not even be concerned about ILEC-imposed price squeezes. In doing so, the ILEC Respondents do not even address the merits of the price squeeze concern, and certainly have not justified the absence of cost recovery for UNEs and collocation in their retail prices.

GTE has argued that competitors need not worry about price-squeezes because "if state and federal regulators do their jobs, there can be no price squeeze," and moreover, "GTE cannot file a federal tariff that does not recover its relevant costs."[32] GTE further argued that to the extent that there are any inconsistencies between the costing data supporting UNEs and the costing data supporting retail DSL services, "these inconsistencies can be remedied through existing procedures in the appropriate forum."[33] These ILEC answers fail to get to the heart of what this proceeding should resolve: How should the Commission respond, and what remedies should be imposed, when ILECs file retail DSL rates that cannot possibly account for the loop and collocation costs needed to provide and to compete with those retail services? As discussed earlier, there is already evidence indicating that ILEC Respondents have in fact filed tariffs that include retail rates that cannot cover relevant costs, and have created a classic anticompetitive price squeeze as a means of limiting entry into the lucrative high-speed data services market.

In an attempt to mask its ability to impose a price squeeze on new entrants, GTE suggests that "the notion of a price squeeze also ignores the numerous competitive options available for high speed Internet access in the marketplace."[34] This is a red herring. The existence of options for access to high-speed services does not mean that some competing providers should operate at an artificial disadvantage due to regulatory costing decisions.[35] The only "options" that would help new entrants are alternative sources for buying inputs, such as other sources of local loops. But there are no such options here as a handful of companies control the inputs, the "essential facilities," needed to provide DSL services.

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[32] GTE Direct Case at 25.

[33] GTE Direct Case at 26.

[34] GTE Direct Case at 25 (citing GTE Telephone Operators GTOC Tariff No. 1 GTOC Transmittal NO. 1148 Reply, CC Docket No. 98-79, DA 98-1020 at 5-6 (May 28, 1998) ("GTE Reply").

[35] This is especially in view of the fact that the ILECs have made it very clear that they have no intentions of reselling their DSL services.

GTE has also suggested that competitors have additional protection from price squeezes because "[t]his outcome is more unlikely because many states require UNEs to be price at long run incremental costs."[36] GTE misses the point here. The price squeeze problem is not just about how UNE prices are determined. As the Commission indicated in a previous evaluation of ILEC long-distance affiliates and price squeezes, "[i]t is this unprofitable relationship between the input prices and the affiliate's prices; and not the absolute levels of those prices, that defines a price squeeze."[37] Regardless of what the UNE prices are, if retail DSL prices assume lower UNE prices or no UNE prices at all, new entrants will not be able to compete effectively.

C. Unless Respondents' DSL Tariffs Contain Rates That Reflect UNE and Input Costs, the Commission Should Reject Those Tariffs and Allow Respondents' to Choose Either to Lower Input Costs or Cease the Cross-Subsidization of Their DSL Services

In addressing whether the Commission should defer its authority over Respondents' DSL services to the states, the ILECs vaguely point to state and federal commissions, as if to say that all will be well if regulators just do their jobs.[38] While Respondents correctly conclude that the Commission should retain its authority over DSL tariffs, Respondents' answers do not explain how a Commission decision to retain authority over DSL tariffs will adequately lessen the ability of ILECs to affect a price squeeze. Yet analysis of DSL rates for price squeeze behavior is not difficult. Specifically, the Commission can lessen the price squeeze concerns of new entrants by

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[36] GTE Direct Case at 25 fn. 67.

[37] NYNEX Corporation and Bell Atlantic Corporation, Petition For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, Memorandum Opinion and Order, 12 FCC Rcd 19985, 20045 ¶ 117 (1997). The Commission was responding to the concerns of long-distance providers that ILECs would create a price squeeze in the long-distance market by charging higher access fees to long distance competitors than to their affiliates offering long-distance services.

[38] BellSouth argued that "no evidence exists that any [state] commission has been impeded in carrying out its respective regulatory functions," and moreover that deferring to the states would "displace the dual regulatory scheme" established by the Act. BellSouth Direct Case at 17-18. Pacific Bell argued that it "fully expects that [the price squeeze concerns] will be raised before the appropriate regulatory body," and moreover "the Commission doesn't lack "the necessary expertise or tools in which to explore and address any legitimate price squeeze issue that might arise." Pacific Bell Direct Case at 16.

evaluating retail rates in the ILECs' DSL tariffs alongside the state-approved cost of UNE inputs needed to provide DSL-based service, and determine whether the rates and costs are inconsistent, and thus effecting an illegal price squeeze.

There are two remedies available to address an illegal price squeeze—ordering a reduction in UNE and collocation rates, and requiring that retail rates reflect all input costs. However, as the Eighth Circuit's decision on UNE rate-setting jurisdiction remains in effect pending Supreme Court review,[39] the Commission currently lacks the authority to reduce the cost of UNEs and collocation. Thus, in the event that the Commission determines that the ILECs' DSL tariffs would effect an impermissible price squeeze, the Commission should simply reject those tariffs and allow the ILEC Respondents to choose either to lower input costs or cease cross-subsidization of their DSL services. In this way, the Commission need not delve into the merits of the state costing proceedings, methodologies or data. Nor would the Commission need to defer to the states to set new UNE rates, because it would exercise its interstate jurisdiction and provide ILECs with a voluntary choice on how to rectify the inconsistency between interstate DSL rates and state-based UNE prices. The Commission can simply condition approval of the ILECs' DSL tariffs on elimination of the price squeeze, either through reductions in UNE prices or, if the ILEC prefers, increases in their interstate DSL rates in order to cover all loop and other input costs.

The ILEC Respondents' arguments supporting their costing methodologies for retail DSL services are suspect. GTE contends that "[a]llocating a greater portion of loop costs to the ADSL service would only force subscribers to pay a higher, noncompetitive rate for their ADSL service, with little possibility of any corresponding reductions in local rates."[40] However, this

[39] Iowa Utilities v. FCC, 120 F.3d 753 (8th 1997).
[40] GTE Reply at 18.

argument fails because local rates need not remain static if a greater portion of loop costs are allocated to the DSL. For instance, the underlying local rates could be based on the extent to which local services utilize the local loop, for instance based on relative use. In stark contrast, however, the ILECs have assumed no loop costs in their retail DSL rates.

GTE justifies the exclusion of all loop costs by stating that "[s]ince local exchange rates are largely averaged throughout a study area, an additional allocation of loop cost to the relatively small number of new ADSL customers would have a de *minimis* effect on local exchange prices."[41] This is essentially an argument that DSL need not bear any allocation of loop costs, despite use of the loop both by voice and DSL services, because current demand for local exchange services exceeds demand for DSL. That is a non sequitur. Moreover, the effect of loop allocation on local exchange prices, whether or not de *minimis*, is irrelevant. They relevant question is the effect on the DSL prices, and how to ensure that DSL retail prices accurately reflect the inputs necessary to produce DSL services. It is particularly important that the Commission focus on the effect on DSL rates because of the revolutionary potential of DSL technology, and the opportunities that new entrants have to participate in a market not yet dominated by the ILECs. Until newer technologies develop, DSL technology could become the preferred technology for communication delivery, and could upset traditional concepts that have classified telecommunications services as basic or enhanced, or interstate and intrastate. Allowing anticompetitive rates could sideline new entrants in that revolutionary process.

Finally, GTE attempts to argue that, even if price squeezes are a concern, GTE should not have to include its loop costs in its DSL tariff rates because "[s]ince ADSL employs the existing loop for new applications, the costs of the loop are already recovered through existing rates."[42]

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[41] GTE's Direct Case at 18 n.53.
[42] GTE Reply at 18.

Moreover, GTE argues that its tariff prices do not create an impermissible price squeeze because its ADSL retail prices "reflect the incremental cost of providing ADSL services," and that "[p]ricing for new regulated services based on incremental costs is completely consistent with the Commission's new service pricing rules."[43] BellSouth similarly argues that "since [m]ost facilities available from a LEC as a UNE are multi-use facilities capable of supporting multiple services, where such facilities are used in the provision of services . . . the revenue derived from all of the services provided that employ these multi-use facilities must recover the costs of those facilities."[44]

What Respondents are advocating here is classic anticompetitive behavior. Respondents are cross-subsidizing their services in order to shift the majority, if not all, of the input costs from competitive services to monopoly services guaranteed to provide a rate of return that will meet those additional costs. Under the ILECs' reasoning, they could price their retail DSL services on the assumption of zero loop costs. This is not an economically rational result. By excluding UNEs and collocation, the inputs that Respondents have included in their cost recovery represent only a shell of Respondents' DSL services. While DSL equipment enables Respondents to provide sophisticated services, the access to UNEs and collocation is still the central component needed to provide DSL services. Thus, to allow Respondents to exclude UNE and collocation costs from their retail rates is anticompetitive and impermissible.

D. Because the Commission's Proposed Affiliate Scheme for ILEC Advanced Services Will Reduce the ILECs' Ability To Effect an Illegal Price Squeeze, Deference to the States Would Be Premature

In a separate but related proceeding, the Commission has outlined a proposal that would allow ILECs to offer DSL services through separate affiliates in order to encourage the deploy-

[43] GTE Reply at 17-18.
[44] BellSouth Reply at 10.